Office of Chief Counsel
Internal Revenue Service

memorandum

POSTF-113351-02
JForsberg

date: August 5, 2002

to: [redacted]

from: Associate Area Counsel (LMSB)
St. Paul, Minnesota

---

subject: [redacted]
Consolidated Returns

Our advice has been requested as to whether [redacted], Inc. ("[redacted]") and [redacted], Inc. ("[redacted]") validly joined in the filing of consolidated Federal income tax returns for the taxable years [redacted], [redacted], and [redacted]. As noted below, we have serious reservations as to whether [redacted] and [redacted] were part of an affiliated group of corporations eligible to file consolidated returns. We do not believe it is necessary to resolve the issue, however, as even assuming that an affiliated group existed, that group did not in fact join in the filing of consolidated returns for the years in issue.

FACTS

[redacted] is a Delaware corporation with a taxable year ending October 31. [redacted] is a [redacted] corporation with a taxable year ending September 30. At all relevant times, 100 percent of the stock of both [redacted] and [redacted] was owned by the [redacted] (the "[redacted]"). The [redacted] is an unincorporated [redacted] of [redacted] acting under a revised constitution and by-laws approved by the [redacted] on [redacted], and amendments thereto approved on [redacted], and [redacted]. As such, the [redacted] is not subject to Federal income taxes and does not file Federal income tax returns.

[redacted] filed separate Federal income tax returns for the TYEs [redacted] and [redacted]. It subsequently filed amended returns for those years which purported to be consolidated returns including the income and expenses of its "subsidiary" [redacted]. An attachment to the TYE [redacted] amended return stated:

[redacted]

[redacted] filed original Federal income tax returns the TYEs [redacted] and [redacted] which purported to be consolidated returns filed with [redacted]. The affiliation schedules (Forms 851) filed with the amended TYE [redacted] and [redacted] returns and the original TYE [redacted] and [redacted] returns showed [redacted] as being a wholly-owned subsidiary of [redacted]. The consolidation schedules attached to the Forms 851 reflected the separate income, deduction, balance sheet, and Schedule M items of [redacted] and [redacted], but not of the [redacted].

[redacted] subsequently filed an amended TYE [redacted] return which made no changes to taxable income or tax, but corrected the Form 851 to show that the [redacted] owned 100 percent of both [redacted] and [redacted]. The consolidation schedules attached to the amended return were substantially identical to those attached to the original, except that they included a column for "[redacted]." Zeros were entered on each line in the column for the [redacted]. The first page of the amended return listed the corporation's name as "[redacted], Inc." and used [redacted]'s EIN. An attachment to the TYE [redacted] amended return stated:

[redacted]

[redacted]

Attached to the amended TYE [redacted] return was a Form 1122 (Authorization and Consent of Subsidiary Corporation to be Included in a Consolidated Income Tax Return) whereby [redacted] purportedly consented to its inclusion in consolidated returns to be filed by [redacted] as common parent. None of the returns filed for taxable years through [redacted] included a Form 1122 whereby [redacted] or [redacted] consent to their inclusion in consolidated returns to be filed by the [redacted] as common parent.

[redacted] filed original separate Federal income tax returns for the TYEs [redacted], [redacted], and [redacted]. [redacted] later filed "amended" returns for those years, stating that it had elected to be included in the consolidated returns filed by [redacted]. [redacted], however, never changed its taxable year to coincide with that of [redacted]. [redacted] did not file a separate Federal income tax return for its TYE [redacted].

DISCUSSION

Section 1501 provides that "[a]n affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns." Section 1504(a)(1) generally defines an "affiliated group" as:

> (A) 1 or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if—
>
> (B)(i) the common parent owns directly stock meeting the requirements of paragraph (2) in at least 1 of the other includible corporations, and
>
> (ii) stock meeting the requirements of paragraph (2) in each of the includible corporations (except the common parent) is owned directly by 1 or more of the other includible corporations.

To meet the stock ownership requirements of paragraph (a)(2), a corporation must own stock possessing at least 80 percent of the total voting power and total value of the includible corporation. I.R.C. §1504(a)(2). Section 1504(b) defines "includible corporation" as any "corporation" subject to certain enumerated exceptions. Section 7701(a)(3) defines a corporation as including "associations, joint-stock companies, and insurance companies." Treas. Reg. §301.7701-2(b) sets forth a more detailed definition of "corporation" which includes, inter alia, business entities organized under a Federal or state statute [redacted]

The amended returns filed by [redacted] for the TYEs [redacted] and [redacted] and original returns filed by it for the TYEs [redacted] and [redacted] purport to be consolidated returns filed by a group consisting of [redacted] and [redacted]. [redacted] and [redacted], however, do not constitute an affiliated group as such a group would have no common parent as neither corporation owns stock of the other (let alone 80 percent as required by paragraph (a)(2) of section 1504). Mere common ownership does not qualify corporations to file consolidated returns. Millette & Associates v. Commissioner, 594 F.2d 121 (9th Cir. 1979); Ray Engineering Co., Inc. v. Commissioner, 42 T.C. 1120 (1964), aff'd, 347 F.2d 716 (3rd Cir. 1965); Foundation Steel and Wire, Inc. v. Commissioner, T.C. Memo 1986-429; Jacqueline, Inc. v. Commissioner, T.C. Memo 1977-340. While [redacted] and [redacted] are brother-sister corporations, they do not by themselves constitute an "affiliated group" and are therefore not eligible to file consolidated returns.

Based on an opinion render by [redacted] in a letter dated [redacted], the taxpayer maintains that [redacted], [redacted], and the [redacted] constitute an affiliated group which has the [redacted] as its common parent and which is eligible to file consolidated returns. In our view, the three entities do not constitute an affiliated group because the [redacted] is not a corporation for Federal income tax purposes and is therefore not an "includible corporation" which can serve as the common parent of an affiliated group. The [redacted] opinion asserts that the [redacted] constitutes a corporation under either paragraph (b)(1), (b)(2), or (b)(7) of Treas. Reg. 301.7701-2(b). While we find the arguments set forth in the [redacted] opinion unpersuasive, we are unaware of any authority directly on point. However, even assuming that the [redacted] is a corporation and therefore *could* file a consolidated return as the common parent of an affiliated group, the fact is that the Band *did not* do so for any of the years in issue.

The original TYE [redacted] and [redacted] returns were filed by [redacted] as separate returns. The original TYE [redacted] and [redacted] and amended TYE [redacted] and [redacted] returns were filed as consolidated returns of a group which had [redacted] as its parent, not the [redacted]. Even the amended TYE [redacted] return, which shows [redacted] and [redacted] as being wholly-owned by the [redacted], was filed in the name of [redacted]. None of the purported consolidated returns reflected income, deductions, or other items of the [redacted]. Further, no Form 1122 has ever been filed by [redacted] or [redacted] to consent to their inclusion in consolidated returns to be filed by a group with the [redacted] as common parent.

Even if the [redacted] could and had filed consolidated returns for the years in issue, [redacted] and [redacted] would not have been entitled to join in such returns for at least two reasons. First, they failed to elect to do so on a timely basis. Treas. Reg. §1.1502-(a)(1) provides that the initial election to file a consolidated return shall be "filed not later than the last day prescribed by law (including extensions of time) for the filing of the common parent's return." Here no such elections were ever filed. Second, Treas. Reg. 1.1502-76(a) requires that "the consolidated return of a group must be filed on the basis of the common parent's taxable year, and each subsidiary must adopt the common parent's annual accounting period for the first consolidated return year for which the subsidiary's income is includible in the consolidated return." Thus, any member of a consolidated group which had the [redacted] as its common parent would have to adopt the "taxable year" of the [redacted]. It is not clear what the "taxable year" would be for an entity like the [redacted] which is not subject to Federal income tax. Whatever it was, however, both [redacted] and [redacted] would have to conform to that same taxable year if they were joining in a consolidated return with the [redacted]. However, as [redacted] and [redacted] have different taxable years (October 31 and September 30, respectively), its clear that at least one, if not both, failed to conform to the [redacted]'s taxable year. Either of these failures would preclude [redacted] and [redacted] from joining in a consolidated return filed by the [redacted]. See, General Mfg. Corp. v. Commissioner, 44 T.C. 513 (1965) (subsidiary not entitled to file consolidated return with parent because (1) subsidiary did not file timely consent to filing of consolidated return, and (2) parent and subsidiary had different taxable years).[1]

---

[1] Treas. Reg. §1.1502.75(b)(3), upon which the taxpayer relies and which allows a corporation which mistakenly or inadvertently filed a separate return to join in the filing of a

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions respecting this matter, please call Jack Forsberg at (651) 290-3473, ext. [redacted].

REID M. HUEY
Associate Area Counsel (LMSB)

By: /s/ Jack Forsberg
JACK FORSBERG
Special Litigation Assistant

---

consolidated return, is not applicable under these facts. That regulation only provides relief where a corporation has mistakenly or inadvertently failed to join in the filing of the return of an existing group. United State v. Lion Associates, Inc., 515 F.Supp. 550 (E.D. Pa. 1981); Rev. Rul. 76-393, 1976-2 C.B. 255.